Supreme Court, U. S.
FILED
SEP 12 1979
MICHAEL RODAK, JR., CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1979

No. ~~79-412~~

PAULINE RUST,

Petitioner

vs.

PAUL JOHNSON and NORA JOHNSON,

Respondents

CITY OF LOS ANGELES, a municipal corporation,

Petitioner

vs.

PAUL JOHNSON, NORA JOHNSON, and the SECRETARY OF HOUSING AND URBAN DEVELOPMENT OF THE UNITED STATES OF AMERICA,

Respondents

PETITION ~~TO THE UNITED STATES SUPREME COURT~~ FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT BY PETITIONER PAULINE RUST

RICH & EZER
L. DOUGLAS BROWN
MITCHEL J. EZER
1888 Century Park East,
Suite 1204
Los Angeles, California 90067
(213) 277-7747
Attorneys for Petitioner
Pauline Rust

SUBJECT INDEX

	PAGE
OPINIONS BELOW	2
JURISDICTION	2
QUESTIONS FOR REVIEW	2
STATEMENT OF FACTS	3
REASONS FOR GRANTING THE WRIT	7
A. THIS MATTER INVOLVES IMPORTANT AND RECURRING ISSUES	7
B. THE NINTH CIRCUIT RESOLVED THIS CASE IN A MANNER THAT IS IN CONFLICT WITH THE LAWS OF THE STATE OF CALIFORNIA	9
C. THE NINTH CIRCUIT HAS DECIDED AN IMPORTANT QUESTION OF FEDERAL LAW WHICH SHOULD BE SETTLED BY THIS SUPREME COURT..	13
D. THE NINTH CIRCUIT ERRED IN CONCLUDING THAT THE INVALIDATION OF A FORECLOSURE SALE UNDER THE SUPREMACY CLAUSE HAS THE EFFECT OF INVALIDATING THE SALE AS TO NON-FEDERAL PARTIES HAVING AN INTEREST IN THE PROPERTY	13
CONCLUSION	15
APPENDIX A	1a
APPENDIX B	1b

TABLE OF AUTHORITIES

CASES: PAGE

City of Los Angeles v. Paul Johnson, et al., No. 77-2493 1

U.S. v. Kimball Foods, Inc., _____ U.S. _____ 59 L. Ed. 2d 711 (1979) 11

U.S. v. Summerlin, 310 U.S. 414, 416 (1940) 14

Von Hoffman v. Quincy, 4 Wall. 535 (1867) 11

STATUTES AND RULES:

United States Constitution (Article VI) 3

28 U.S.C. § 1254 2

28 U.S.C. § 1442(a)(1) 6

California Civil Code Section 2924 *et seq.* 4

California Improvement Act of 1911, Streets and Highways Code, Sections 5000 *et seq.* 2

National Housing Act, Section 309(c)(2)[12 USC Section 1723a(c)(2)] 10

IN THE

Supreme Court of the United States

OCTOBER TERM, 1979

No._____

PAULINE RUST,

Petitioner

vs.

PAUL JOHNSON and NORA JOHNSON,

Respondents

CITY OF LOS ANGELES, a municipal corporation,

Petitioner

vs.

PAUL JOHNSON, NORA JOHNSON, and the SECRETARY OF HOUSING AND URBAN DEVELOPMENT OF THE UNITED STATES OF AMERICA,

Respondents

PETITION TO THE UNITED STATES SUPREME COURT FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT BY PETITIONER PAULINE RUST

Petitioner prays that a Writ of Certiorari issue to review the decision of the United States Court of Appeals for the Ninth Circuit in *Pauline Rust v. Paul Johnson, et al.*, No. 77-2602, and a consolidated matter, *City of Los Angeles v. Paul Johnson, et al.*, No. 77-2493. This case was heard by the Ninth Circuit and decided on May 10, 1979. Petitions for rehearing filed by both Pauline Rust and the City of Los Angeles were thereafter denied by the Ninth Circuit on June 14, 1979.

OPINIONS BELOW

The decision of the United States District Court for the Central District of California is unpublished. A copy is filed herewith as Appendix "A". The opinion of the United States Court of Appeals for the Ninth Circuit, while certified for publication, has not yet been published. Accordingly, a copy of that decision is filed herewith as Appendix "B".

JURISDICTION

The jurisdiction of this Court is invoked under the provisions of 28 U.S.C. § 1254 in that this is an appeal from a decision of the United States Court of Appeals for the Ninth Circuit, dated May 10, 1979. As stated above, a petition for rehearing filed by petitioner Pauline Rust was denied by the Ninth Circuit on June 14, 1979.

QUESTIONS FOR REVIEW

1. Was the City of Los Angeles properly entitled to subject real property in which either the Federal National Mortgage Association [hereinafter "FNMA"] or the Secretary of Housing and Urban Development [hereinafter "HUD"] claims a lienholder interest to the lien of a street improvement bond under the provisions of the California *Streets and Highway Code* [*Streets and Highway Code,* Section 5000 *et seq.*]?

2. If the answer to Question No. 1 is affirmative, was the City of Los Angeles entitled to enforce the lien of the street improvement bond through non-judicial foreclosure proceedings prescribed by the California *Streets and Highway Code* [*Streets and Highway Code* Section 6500 *et seq.*], even as against the interest of HUD as a junior lienholder?

3. If the answer to Question No. 2 is negative, what procedures should the City of Los Angeles have taken, if any, to validate a foreclosure sale as against either of the following asserted interests in the real property:

a. The interest of HUD as the holder of a deed of trust on the real property.

b. The interest of Paul and Nora Johnson, private individuals, who were the owners of the real property.

4. Assuming *arguendo* that the Ninth Circuit properly concluded that the City of Los Angeles could not enforce the street improvement bond as against the lienholder interest of HUD, was it error to conclude that this failure invalidated the sale *per se* as to all other parties, including Paul and Nora Johnson? Or, stated another way, does a conclusion that HUD is immune from the effects of the foreclosure sale under the "supremacy clause" of the *United States Constitution* [*U.S. Constitution,* Article VI] mean, as the Ninth Circuit has apparently concluded, that the sale is invalidated as to other non-federal instrumentalities or persons who claim an interest in the same property, such as Paul and Nora Johnson?

STATEMENT OF FACTS[1]

This case arises out of the foreclosure of a street improvement bond on a parcel of property located at 342 East 105th Street in Los Angeles, California [hereinafter the "Property"].

The Property was purchased on December 3, 1968, by Cecil Carl Presley and Jeweline Presley who took title subject to a deed of trust in favor of Imperial Bank, a bank chartered under California law, as security for a purchase money loan.

[1] Except as otherwise noted, all facts are as found in the District Court's Findings of Fact and Conclusions of Law. Clerk's Record, pages 205-211. Hereinafter, the Clerk's Record will be designated as C.R. and the Reporter's Transcript as R.T.

The deed of trust was insured by the Federal Housing Administration [hereinafter "FHA"], a branch of HUD. On April 3, 1969, the beneficial interest under the deed of trust was assigned to FNMA.

On July 19, 1971, FNMA recorded with the Los Angeles County Recorder a Notice of Default and Election to Sell Under Deed of Trust and simultaneously recorded a Substitution of Trustee substituting itself as trustee in place of Imperial Bank. On August 14, 1971, the City of Los Angeles, a municipal corporation, levied Bond No. 746, Series 5 on the Property for the improvement of 103rd Street pursuant to the provisions of the California *Improvement Act of 1911* [*Streets and Highways Code* Sections 5000 *et seq.*] At that time, the Property was still owned by the Presleys subject to the deed of trust in favor of FNMA as assignee from Imperial Bank of the beneficial interest under the deed of trust. HUD had no interest in the Property at that time.

On November 19, 1971, FNMA paid the first installment of $14.00 on the street improvement bond.

On January 19, 1972, FNMA, as trustee, conveyed the Property to itself as part of a non-judicial foreclosure sale under California *Civil Code* Section 2924 *et seq.* The trustee's deed was recorded January 20, 1972. On January 25, 1972, FNMA executed a grant deed, recorded March 3, 1972, conveying the Property to HUD in return for payment to FNMA of FHA mortgage insurance benefits.

After the conveyance to HUD, no further payments on the pre-existing street improvement bond were made and the bondholder, Gross and Company, demanded foreclosure pursuant to Section 6505 of the *Streets and Highway Code.* Notice of pendency of the bond foreclosure sale was recorded as required by Section 3121 of the *Streets and Highway Code* and, on July 26, 1973, Notice of Sale was mailed to the following parties:

1. Cecil Carl Presley
   342 East 105th Street
   Los Angeles, California 90003

2. Federal National Mortgage Association
   Secretary of Housing and Urban Development
   FHA Asst. Commissioner Controller
   Washington, D.C.

3. Housing and Urban Development
   Property Management Division
   2500 Wilshire Boulevard
   Los Angeles, California 90057

(C.R. p. 207; R.T. pp. 44-45; Plaintiff's Exhibit 5)

On September 21, 1973, a grant deed was recorded whereby HUD conveyed the Property to Respondents Paul and Nora Johnson. No down payment was required and a promissory note for the entire purchase price was secured by a deed of trust in favor of a private lender, California Mortgage Service, as beneficiary. The promissory note and deed of trust were insured by FHA. On January 10, 1974, the beneficial interest under the deed of trust was assigned by California Mortgage Service to FNMA.

On February 28, 1974, a second notice of the bond foreclosure sale was sent by the City Treasurer of Los Angeles to:

1. Federal National Mortgage Association
   Secretary of Housing and Urban Development
   FHA Asst. Commissioner Controller
   Washington D.C.

2. Cecil Carl Presley
   342 East 105th Street
   Los Angeles, California 90003

On March 18, 1974, a sale to foreclose the street improvement bond was held in the Office of the City Treasurer and Certificate of Sale No. 11883 was issued to the purchaser, petitioner Pauline Rust. On February 28, 1975, a Notice to Redeem the subject Property from the bond foreclosure sale was posted on the Property and mailed to Paul and Nora Johnson. The Notice to Redeem told the Johnsons that they could redeem the Property by payment of the redemption price set forth therein. The Johnsons admit to having received the posted notice on the same day and the mailed notice shortly thereafter. Notwithstanding receipt of the Notice to Redeem, the Property was not redeemed by the Johnsons and, on March 31, 1975, the City Treasurer issued a Treasurer's Deed, recorded April 1, 1975, conveying the Property to Pauline Rust. (C.R. page 208; Pretrial Conference Order, C.R. page 125)

When Paul and Nora Johnson refused to deliver the Property to Pauline Rust, this litigation was commenced on January 26, 1976, by the filing of a Complaint for Ejectment in the Los Angeles Superior Court, Case No. C 147691. On February 13, 1976, the Johnsons filed an Answer and separate Cross-complaint naming as co-defendants Pauline Rust, the City of Los Angeles, and HUD. Answers to the Cross-complaint were filed in the Superior Court by Pauline Rust on April 2, 1976, and by the City of Los Angeles on April 26, 1976.

On June 12, 1976, HUD filed a Petition for Removal in the United States District Court for the Central District of California pursuant to 28 U.S.C. Section 1442(a)(1).

A trial was held in the District Court on February 10, 1977. A Judgement and Findings of Fact and Conclusions of Law (Appendix "A") were filed by the District Court on May 5, 1977. The Judgment was in favor of HUD and Paul and Nora Johnson, and against petitioner Pauline Rust and the City of Los Angeles.

Thereafter, on May 10, 1979, the United States Court of Appeals for the Ninth Circuit affirmed the District Court (See Appendix "B"). Both the City of Los Angeles and Pauline Rust filed petitions for rehearing which were denied by the Ninth Circuit on June 14, 1979.

The decision of the Ninth Circuit was premised on the following conclusions:

1. That the conduct of the non-judicial foreclosure sale was an "exercise of state power."

2. That the "exercise of state power" occurred with respect to "property of the United States."

3. That the "exercise of state power" over "property of the United States" violated the "supremacy clause" of the United States Constitution [*U.S. Constitution,* Article VI].

REASONS FOR GRANTING THE WRIT

A. THIS MATTER INVOLVES IMPORTANT AND RECURRING ISSUES

The instant action involves important and recurring issues related to the enforceability of municipal improvement bonds against real property in which an instrumentality of the federal government may have a lien interest. As aptly but unsuccessfully argued by the City of Los Angeles in its Opening Brief to the Ninth Circuit:

> "The importance of the issues raised in this case in the area of federal-local relationships cannot be overemphasized. If HUD's contention that it acquires property free of preexisting assessment liens and bonds is upheld, the effect upon the ability of local government to finance

local improvements could be disasterous. HUD operates in the essentially private real estate market on an enormous scale. In the calendar year 1976, FHA insured a total of 554,193 mortgages and loans. During the same period, HUD sold 52,290 acquired home properties which produced a cash flow of over $575 million to the mortgage insurance funds, but as of December 31, 1976, HUD still retained an inventory of 35,034 properties."

"The import of HUD's contentions in the present case is that the liens of preexisting assessments and bonds on each of the properties HUD owns is at least suspended for the period of time of any HUD ownership. During 1976, HUD at one time or another owned 87,324 properties (the total of the inventory of properties remaining on December 31 plus the houses sold during the year). Moreover, HUD's 'revolving door' experience with its mortgage insurance program is common knowledge; HUD acquires title to property such as this again and again. The dimensions of the experience prompted a Congressional subcommittee hearing on the subject."

"If such property is free from the liens of street improvement bonds imposed while HUD has no interest and from the initiation of procedures to enforce those liens, of what value are the bonds? A local public body or potential investor could never be sure when a local improvement were constructed, or assessment levied or bond thereon issued that the lien thereof would not at any moment become at least temporarily unenforceable. Street improvement bonds under the Improvement Act of 1911 are typically issued for payment over a period of ten years as was the case here. During that period of time, HUD could come in and out of title numerous times. The subject property has been owned by HUD at least twice, those two

times in the five year period between 1968 and 1973. What contractor would agree to accept such bonds in return for construction work? What investor would buy a bond the payments on which could be indefinitely suspended at any time and any number of times?"

"The contentions argued by HUD, if upheld, would be one more blow to the ability of cities to deal with pressing urban problems. A large portion of HUD's activities are conducted in the lower income urban areas that most require public improvement to help prevent further deterioration and to foster revitalization. Yet HUD's contentions would seriously undermine the viability of the 1911 Act which, along with predecessor acts, has been one of the most important tools for local improvement in California for nearly a century."

Petitioner Pauline Rust fully subscribes to the foregoing view and believes that crisis foreseen therein, as well as the following specific arguments, requires review of this matter by this Honorable United States Supreme Court.

B. THE NINTH CIRCUIT RESOLVED THIS CASE IN A MANNER THAT IS IN CONFLICT WITH THE LAWS OF THE STATE OF CALIFORNIA

As stated previously, the Ninth Circuit in substance resolved this matter on the grounds that the interest of HUD as a lienholder on the Property cannot be impaired or affected by actions of the City of Los Angeles under the *Improvement Act of 1911* [*Streets and Highway Code*, Section 5000 *et seq.*]. The principal buttress for this conclusion is the "supremacy clause" of the United States Constitution, which is found in Article VI thereof.

That this conclusion is in conflict with the laws of the State of California cannot be denied. The *Improvement Act of 1911* provides of a means of equally assessing all real property benefited by a particular municipal improvement, and does not differentiate between those which are encumbered by mortgages held by conventional lending institutions, and those which have liens which are held or insured by federal instrumentalities such as FNMA or HUD.

Petitioner respectfully submits that the Ninth Circuit erred in concluding that the "supremacy clause" requires that the federal lien interest be excluded from the non-judicial foreclosure in this case.

On one level, that error is found, we believe, in the conclusion that federal law currently exists which exempts the HUD lien interest from street improvement bonds. To the contrary, both petitioner and the City of Los Angeles argued to the Ninth Circuit that the street improvement bond was clearly a valid encumbrance on the interest of FNMA when levied. Thus, Section 309(c)(2) of the *National Housing Act* [12 USC Section 1723a(c)(2)] directed with respect to FNMA that:

> "The corporation, including its franchise, capital, reserves, surplus, mortgages or other security holdings, and income, shall be exempt from all taxation now or hereafter imposed by any state, territory, possession, Commonwealth, or dependency of the United States . . . or by any county, municipality, or local taxing authority, except that any real property of the corporation *shall be subject to State, territorial, county, municipal, or local taxation to the same extent as other real property is taxed.*" (Emphasis added)

To the extent that the street improvement bond was valid when originally levied, petitioner submits that the enforcement was a valid act as long as it was consistent with procedures under the *Improvement Act of 1911.* As observed by this

Supreme Court in an early decision, "nothing can be more material to the [bond] obligation than the means of enforcement. . . . [T]he idea of validity and remedy are inseparable." *Von Hoffman v. Quincy,* 4 Wall. 535 (1867).

Beyond this, petitioner believes that there is no binding precedent under federal law for the proposition that where HUD acquires an interest "subject to" a pre-existing street improvement bond, that this has the effect *ipso facto* of either invalidating or rendering unenforceable an otherwise valid lien. And yet, despite the absence of any such authority, the effect of the Ninth Circuit decision is to mandate exactly that result. If allowed to stand, the chaos that must result from the "on again, off again" validity of street improvement bonds, as HUD acquires and disposes of lien interests in real property, will make the Mad Hatter's teaparty look rational by comparison. Petitioner does not contend with the notion that a municipality cannot impose an unconsented to tax lien on a pre-existing federal interest. But where, as here, the only federal interest at the time of levy was held by FNMA, as to which Congress had given consent to assessment pursuant to Section 309(c)(2) of the *National Housing Act,* and HUD (as to whom Congress had given no such specific consent) acquired its interest only after the levy of the street improvement bond, federal law does not invalidate either the levy or enforcement of the street improvement bond.

Finally, the recent decision of this Supreme Court in the case of *United States v. Kimball Foods, Inc.,* .... U.S. ...., 59 L. Ed. 2d 711 (1979) casts considerable doubt on the conclusions reached by the Ninth Circuit insofar as the interests of HUD are concerned. In that case, after acknowledging the time honored "Clearfield Trust Doctrine", that federal law governs questions relating to federal lien rights [*Id.* at 722], the Supreme Court went on to announce that:

> "Controversies directly affecting the operations of federal programs, although governed by federal law, do not

inevitably require resort to uniform federal rules . . . [citations omitted] . . . [W]hether to adopt state law or to fashion a nationwide federal rule is a matter of judicial policy dependent upon a variety of considerations always relevant to the nature of the specific governmental interests and to the effects upon them of applying state law . . . [citations omitted] . . ."

Id. at 723-724.

The Supreme Court then concluded that, in the case of loan programs administered by both the U.S. Small Business Administration and the Farmers Home Administration, state law could be used as the federal rule of decision to determine lien priority issues. In so doing, the Supreme Court stated:

". . . the prudent course is to adopt the readymade body of state law as the federal rule of decision until Congress strikes a different accommodation. . . . [A]ccordingly, we hold that absent a congressional directive, the relative priority of private liens arising from these Government lending programs is to be determined under non-discriminatory state laws."

Id. at 731.

Although the facts of this case and those in *Kimball Foods* are not identical, petitioner believes that there are strong parallels to be drawn between the two situations. Curiously, the Ninth Circuit cited *Kimball Foods,* but it appears to have misperceived its significance as applied to the instant case. Petitioner believes that the *Kimball Foods* case means that, unless Congress acts to create federal legislation exempting property encumbered by HUD liens from street improvement bonds, the validity and enforceability of such bonds must be measured by California law. It is submitted that, under California law, the street improvements bonds were fully valid and enforceable, even as against the lien interest of HUD. By

failing to redeem the Property from the default under the street improvement bond, both HUD and the owners of the Property should have been subject to the enforcement rights set forth in the *Improvement Act of 1911* (*Streets and Highway Code* Section 6500 *et seq.*).

C. THE NINTH CIRCUIT HAS DECIDED AN IMPORTANT QUESTION OF FEDERAL LAW WHICH SHOULD BE SETTLED BY THIS SUPREME COURT

For the reasons set forth in Section B above, and particularly those relative to the application of the *Kimball Foods* decision to the situation of municipal street improvement bonds, it appears to petitioner that the Ninth Circuit has decided an important federal question in an erroneous manner. That question should be settled by this Supreme Court to resolve uncertainty that has been generated therefrom.

D. THE NINTH CIRCUIT ERRED IN CONCLUDING THAT THE INVALIDATION OF A FORECLOSURE SALE UNDER THE SUPREMACY CLAUSE HAS THE EFFECT OF INVALIDATING THE SALE AS TO NON-FEDERAL PARTIES HAVING AN INTEREST IN THE PROPERTY.

Respondents Paul and Nora Johnson are a married couple who, beyond question, cannot be considered instrumentalities of the United States government. It is therefore curious that the Ninth Circuit was able to affirm the District Court judgment in their favor solely on the grounds that the "supremacy clause" had invalidated the foreclosure sale.

Assuming *arguendo* that the "supremacy clause" bars enforcement of the local lien as against a federal interest in the Property, it can have no conceivable impact on the Johnsons.

Even if the Ninth Circuit was correct in holding that the HUD lien remains on the Property, that has no bearing on whether the interest of Paul and Nora Johnson has been extinguished.

The Ninth Circuit totally failed to deal with the rights, if any, that exist between Pauline Rust, on the one hand, and the Johnsons, on the other hand.

In the District Court, petitioner Rust asserted that the cross-complaint filed by respondent Johnson challenging the validity of the bond foreclosure sale was barred by the six month statute of limitations provisions of California *Streets and Highway Code* Section 6571 insofar as said cross-complaint sought to set aside the foreclosure of street improvement bond.

Notwithstanding the foregoing, the District Court failed to address the issue of the statute of limitations argument in its Findings of Fact and Conclusions of Law (Appendix "A").

In part because of the foregoing failure, petitioner Rust prosecuted the appeal to the Ninth Circuit. While conceding that the provisions of *Streets and Highway Code* Section 6571 probably had no applicability to the claims of HUD [see *U.S. v. Summerlin,* 310 U.S. 414, 416 (1940)], petitioner Rust nevertheless vigorously argued to the Court, both in her Opening Brief, and on oral argument, that the provisions of Section 6571 did operate to bar the claims of the Johnsons. The basis for the distinction between the government respondent (i.e. HUD) and the individual respondent (i.e. Johnson) was simply the rule that state statutes of limitations were not applicable to claims of the federal government.

In its decision, however, the Ninth Circuit itself failed to address the issue of the effect that the provisions of Section 6571 had on the cross-complaint of respondent Johnson. Presumptively, he claims were dismissed in Section IV of the decision on the grounds that it was unnecessary to decide the issue due to the conclusion that the sale was invalid under the "supremacy clause". Appendix "B", page 11.

Petitioner Rust respectfully submits that the issue of the application of Section 6571 to the claims of the Johnsons cannot properly be disposed of in this fashion. The reason for this contention is that the sale was found by the Ninth Circuit to be invalid insofar as HUD was concerned essentially on the grounds of federal supremacy. While such a conclusion, if correct, is sufficient to dispose of all subordinate arguments directed against HUD, it does not deal at all with the question of the rights of the Johnsons who are not entitled to benefit from the "supremacy clause". Mr. and Mrs Johnson, as private parties, are fully subject to the provisions of Section 6571, and petitioner Rust submits that the Ninth Circuit should have addressed that argument.

CONCLUSION

The issues involved in this case have not specifically be ruled upon by this Court. Petitioner believes that the Ninth Circuit erred in its decision and that, unless this Court resolves the questions raised, the decision below will have a grave impact on the ability of municipalities to finance local improvements through the use of improvement bonds. A shadow has now fallen on the question of whether improvement bonds are a viable method of municipal financing, given the uncertainty of enforcement rights, and this Court must furnish illumination.

For the reasons hereinabove set forth, petitioner Pauline Rust respectfully requests that this Honorable Supreme Court grant the within petition and issue a writ of certiorari, as prayed.

RICH & EZER
L. DOUGLAS BROWN
MITCHEL J. EZER
Attorneys for Petitioner
Pauline Rust.

APPENDIX A

UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA

PAULINE RUST,
Plaintiff,
v.
PAUL JOHNSON, NORA JOHNSON, etc., et al.,
Defendants.

PAUL JOHNSON AND NORA JOHNSON,
Cross-Complainants,
v.
PAULINE RUST, THE CITY OF LOS ANGELES, SECRETARY OF HOUSING AND URBAN DEVELOPMENT, etc., et al.,
Cross-Defendants.

CARLA HILLS, Secretary of Housing and Urban Development,
Cross-Claimant,
v.
PAULINE RUST,
Cross-Defendant.

NO. CV-76-1771-MML

FINDINGS OF FACT AND CONCLUSIONS OF LAW

This matter having come on regularly for trial before the Honorable Malcolm M. Lucas, United States District Judge, the plaintiff being represented by L. Douglas Brown, Esquire, the defendants being represented by Clarence E. Blair, Esquire, the City of Los Angeles being represented by Deputy City Attorney Ken Cerlin and the Cross-Defendant Secretary of Housing and Urban Development being represented by Assistant United States Attorney J. Mark Waxman, and the court having read and considered all the pleadings, files, documents and memo-

randa presented in this case, as well as the evidence introduced at trial, and the oral presentation of counsel, the court makes the following Findings of Fact and Conclusions of Law:

FINDINGS OF FACT

1. On December 3, 1968, Cecil Carl Presley and Jeweline Presley purchased the property which is the subject of this action subject to an FHA insured mortgage (FHA Case No. 041-212166-221). The first payment under the mortgage which was held by Imperial Bank was due February 1, 1969.

2. On April 3, 1969, the mortgage was assigned by Imperial Bank to the Federal National Mortgage Association.

3. On February 1, 1971, the mortgage went into default, and on July 19, 1971, FNMA instituted foreclosure proceedings.

4. On August 14, 1971, Bond No. 746, Series 5, for the improvement of 103rd Street was levied by the City of Los Angeles, ostensibly pursuant to the provisions of the Improvement Act of 1911. *See* California Streets and Highways Code §§ 5000 *et seq.*

5. On November 19, 1971, the first installment of $14.00 due under the bond was paid by FNMA in preparation for conveying clear title to the Secretary in exchange for mortgage insurance benefits.

6. On March 3, 1972, the property was conveyed to the Secretary in exchange for FHA insurance benefits after FNMA foreclosed the mortgage. It was during this period of the Secretary's ownership of the property that no payments were made on the bond installments. The City of Los Angeles used this fact to declare delinquency on the bond.

7. On July 18, 1973, a contract of sale was signed for the subject property between the Secretary and Paul and Nora Johnson.

8. On July 26, 1973, a notice of sale of property delinquent for nonpayment of street improvement was sent by the City to:

(1) "Cecil Carl Presley
342 East 105th Street
Los Angeles, California 90003."

(2) "Federal National Mortgage Association
Secretary of Housing and Urban Development
FHA Asst. Commission Controller,
Washington, D.C."[sic]

(3) "Housing and Urban Development
Property Management Division
2500 Wilshire Boulevard
Los Angeles, California 90057"

9. On September 21, 1973, a deed to Paul and Nora Johnson and deed of trust to the California Mortgage Service were recorded. The deed of trust was insured by FHA (Case No. 041-388147-235).

10. On January 10, 1974, the deed of trust relating to the Johnsons and the note was assigned to FNMA by California Mortgage Service.

11. On February 28, 1974, a second notice was sent to:

"Federal National Mortgage Association
Secretary of Housing and Urban Development
FHA Assistant Commissioner Controller
Washington, D.C."

"Cecil Carl Presley
342 East 105th Street
Los Angeles, California 90003"

12. On March 18, 1974, Pauline Rust purchased the property at a sale held by the City and was issued Certificate of Sale No. 11883.

13. The City then issued a Notice to Redeem dated February 28, 1975.

14. On March 28, 1975, an Affidavit of Service of Notice to Redeem was made, but it indicated the property was unoccupied. It did not state to what address the Notice was mailed.

15. When no redemption took place, the Treasurer of the City of Los Angeles deeded the property to Pauline Rust. Although dated March 31, 1975, the deed was not notarized until April 1, 1975.

16. On March 11, 1976, the deed of trust and note were assigned to the Secretary. The deed of trust assignment was recorded March 29, 1976.

17. The evidence presented fails to establish the claim that cross-complainants, Paul Johnson and Nora Johnson, or either of them, suffered emotional distress caused by the intentional outrageous conduct of the cross-defendants, Pauline Rust and City of Los Angeles.

CONCLUSIONS OF LAW

1. This court has jurisdiction over both the parties hereto and the subject matter of this action.

2. At issue in this case was the ability of the City of Los Angeles to sell property because of the failure of special assessment payments to be made. The reason that the City of Los Angeles commenced foreclosure and sale proceedings was that the Secretary of Housing and Urban Development, while

the Secretary owned the land, failed to make payments on special assessments. Congress has not consented to the collection of such special assessments against the Secretary, however, and therefore the action of the City to require payment of assessment installments in this case was an unconstitutional exercise of State power over property of the United States. See *United States v. City of Adair,* No. 75-1608 (8th Cir., 1976); *Board of Directors of Red River Levee District No. 1 of Lafayette County, Arkansas* v. *Reconstruction Finance Corp.,* 170 F.2d 430 (8th Cir., 1948). See also *Van Brocklin v. Tennessee,* 117 U.S. 151 (1886).

3. In selling the property which is the subject of this lawsuit, the City failed to comply with the requirements of the Improvement Act of 1911, California Streets and Highways Code, §§ 5000, *et seq.* The City failed to comply in at least two respects. First, the Notice to Redeem was defective because the City of Los Angeles erroneously calculated the amount required for redemption. The notice to redeem issued by the City of Los Angeles indicated that $169.04 was required to be paid to redeem the property. The proper calculation, however, is set forth as follows pursuant to California Streets and Highways Code § 6531:

$146.65	purchase money
3.00	filing
3.00	recording (§ 6531(c))
.50	§ 6553
$153.15	
16.84	Interest 11 months at 1%
$169.99	

Second, the procedure was faulty because it failed to give the Johnsons, as the owners of the property, notice of the proposed sale prior to the sale. See *Friedman v. City of Los Angeles,* 52 Cal.App.3d 317 (1975) 125 Cal.Rptr. 93.

4. By virtue of the inability of the City of Los Angeles to sell the property as it did in this case, all right, title and interest in the property, which is the subject of this action, is declared to be held by Paul Johnson and Nora Johnson, subject to a deed of trust and note on the property which has been assigned to the Secretary as of March 11, 1976. Plaintiff Pauline Rust has no right, title or interest of any kind whatsoever in the property, and her claims are void and of no effect.

5. Neither Paul Johnson nor Nora Johnson are entitled to recover on their claim for intentional infliction of emotional distress.

Dated: May 5, 1977

MALCOLM M. LUCAS
Malcolm M. Lucas
United States District Judge

APPENDIX B

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

PAULINE RUST, *Appellant,* v. PAUL JOHNSON and NORA JOHNSON, *Respondents.*	No. 77-2493.
CITY OF LOS ANGELES, *Appellant,* v. PAUL JOHNSON, NORA JOHNSON, and THE SECRETARY OF HOUSING AND URBAN DEVELOPMENT, *Respondents.*	No. 77-2602.

OPINION

Appeal from the United States District Court
Central District of California

Before: WALLACE and HUG, Circuit Judges, and TEMPLAR, District Judge.*

This case arises out of the foreclosure of a street improvement bond on a parcel of property located at 342 East 105th Street in Los Angeles, California. The foreclosure resulted in two parties claiming title to the property and in a dispute over the power of the City of Los Angeles to foreclose on property in which the United States holds an interest.

---

* Hon. George Templar, Senior United States District Judge for the District of Kansas, sitting by designation.

FACTS

On August 14, 1971, the City of Los Angeles (City) assessed the property for street improvements in the amount of $158.36 and issued a bond to pay the assessment. At the time of the assessment, the Federal National Mortgage Association (FNMA) was in the process of foreclosing on a purchase money mortgage interest which it held in the property under a deed of trust. The deed of trust was insured by the Federal Housing Administration (FHA) and had been previously assigned to FNMA by the Imperial Bank.

FNMA completed its foreclosure and, on March 3, 1972, it conveyed the tract to the Secretary of Housing and Urban Development (HUD) in exchange for FHA insurance benefits. HUD owned the property from March 3, 1972 until September 21, 1973. During the period of its ownership, HUD did not made any payments on the street improvement bond. Consequently, the City commenced foreclosure and, on July 26, 1973, it sent notice to HUD and FNMA that the property would be sold for non-payment of installments due on the bond.

On September 21, 1973, HUD conveyed the tract to Paul and Nora Johnson. The Johnsons mortgaged the property in a deed of trust which they delivered to the California Mortgage Service. The deed secured a promissory note for the purchase price of the property and was insured by FHA. The California Mortgage Service assigned the deed of trust to FNMA on January 10, 1974 and FNMA held the deed until subsequent to the filing of this lawsuit when it assigned its rights to HUD.

The City posted a notice on the property and sent a second notice of sale to HUD and FNMA on February 28, 1974. Pursuant to the notice, the City completed foreclosure and sold the property to Pauline Rust on March 18, 1974. Rust received

a treasurer's deed conveying the tract to her on March 31, 1975 and she later brought this action in state court to eject the Johnsons from the property.

The Johnsons filed a cross-complaint naming as cross-defendants Pauline Rust, the City of Los Angeles, and HUD. HUD had the case removed to federal district court where, after a trial on the merits, the court held that the action of the City to collect payment on the bond was an unconstitutional exercise of state power over property of the United States. Accordingly, judgment was entered quieting title in the Johnsons and declaring the sale to Rust invalid. Rust and the City appeal.

DISCUSSION

I

Appellants challenge the district court's characterization of the non-judicial foreclosure as an "exercise of state power." Foreclosure on a street improvement bond is authorized by Section 6500 of the California Streets and Highways Code which provides:

> "Whenever payment upon either the principal or the interest of any bond is not made to the bondholder when the coupon therefor is due, and the holder of the bond demands in writing that the [City] treasurer proceed to advertise and sell the lot or parcel of land described in the bond as being that upon which the assessment represented by the bond was levied, the treasurer shall proceed to advertise and sell the lot or parcel of land as provided in this chapter . . ."

In exercising the powers conferred by the statute, the City contends that the treasurer acts only as the special agent of the bondholder and that the City has no interest in either the bond or the payments. This argument ignores the purpose and

operation of the statutory scheme. Under the Code, the City is authorized to order improvements, make assessments, issue bonds, collect payment on the bonds, and to convey delinquent property after foreclosure is completed. Streets & Highways §§ 5240, 5343, 6422, 6500, 6555. These functions are performed pursuant to the taxing power of the state and in furtherance of the governmental purpose of providing for such improvements as the public interest or convenience may require. *Bryant v. Commissioner of Internal Revenue,* 111 F.2d 9, 13-14 (9th Cir. 1940); *City of Baldwin Park v. Stoskus,* 105 Cal.Rptr. 325, 503 P.2d 1333, 1335-36 (1972); *San Diego County v. Childs,* 217 Cal. 1109, 17 P.2d 734, 738 (1938); Streets & Highways § 5101.

The entry of the bondholder into the transaction does not make the City any less interested in seeing that its assessments are paid. As this lawsuit demonstrates, the City remains involved in the enforcement of the lien after a bond has been issued and it has exclusive responsibility under the Code for conducting non-judicial foreclosures against delinquent property. Streets & Highways §§ 6500-6555. Therefore, we hold that the City is significantly involved in the process of collecting payments on a street improvement bond and that the action taken in this case was an exercise of state power. *See generally Melara v. Kennedy,* 541 F.2d 802, 804-05 (9th Cir. 1976); *Adams v. Southern California First National Bank,* 492 F.2d 324, 330-31 (9th Cir. 1973), *cert. denied* 419 U.S. 1006 (1974).

II

Appellants also challenge the district court's determination that the City exercised its power over "property of the United States." Appellants' contention rests in part on the assumption that "property of the United States" includes only property actually owned by the United States and does not include a

mortgage interest held by a federal instrumentality. No basis in law exists for treating mortgage interests of federal instrumentalities differently from other property of the United States. *City of New Brunswick v. United States,* 276 U.S. 547 (1927); *United States v. Roessling,* 280 F.2d 933, 936 (5th Cir. 1960); *Branden v. Driver,* 293 F.Supp. 871, 872-73 (N.D.Cal. 1968), affirmed 441 F.2d 1171 (9th Cir. 1971); *Clark Investment Co. v. United States,* 364 F.2d 7, 9 (9th. Cir. 1966).

Nevertheless, appellants contend that FNMA should not be treated as a federal instrumentality. The reasons advanced for this contention are: (1) that FNMA is a privately owned corporation and (2) that FNMA engages in certain non-governmental functions. Responding to the argument that FNMA should be treated like a private lending institution, we are persuaded that such a contention is contrary to the intent expressed when the Act creating the present corporate structure of FNMA was enacted by Congress.

FNMA owes its existence to Congressional recognition of the importance of secondary credit in bringing about the National goal of "a decent home and a suitable living environment for every American family." U.S. Code Service at 2027, 2042 (1950); 12 U.S.C. § 1701t. Congress intended FNMA to operate as a reserve market for mortgage investors and to thereby facilitate the distribution of investment capital available for home mortgage financing. U.S. Code Service at 2041 (1950); 12 U.S.C. § 1716. To assist FNMA in the performance of its secondary market functions, Congress enacted laws granting FNMA special rights and privileges. For example, FNMA is exempt from having to qualify to do business in any state and it has immunity from state taxation (except for taxes on real estate). 12 U.S.C. §§ 1723(a), 1723a(c)(2).

In 1968, Congress transferred ownership of FNMA to the private sector. 12 U.S.C. § 1718, as amended (Supp.). The change came about as a result of Congressional intent to reduce

the impact of FNMA's operations on the budget of the United States. U.S. Code Service at 2041 (1950); U.S. Code Cong. & Ad. News at 2943-44 (1968). In making the change in FNMA's capital structure, Congress indicated in its legislative history that: "The new FNMA would be a Government-sponsored private corporation, regulated by the Secretary and would have a status analogous to that of the Federal land banks and the Federal home loan banks." Cong. & Ad. News, *supra.*

We have been unable to find anything in the legislative history or in the statutes governing the operation of FNMA which supports the conclusion that Congress intended to strip FNMA of its status as a federal instrumentality. A survey of the cases involving the Federal land banks and the Federal home loan banks reveals that they are treated as federal instrumentalities engaged in the performance of governmental functions even though their stock may be privately owned. *Federal Land Bank v. Priddy,* 295 U.S. 229, 231 (1935); *Federal Land Bank v. Bismarck Lumber Co.,* 314 U.S. 95, 101-04 (1941); *Fahey v. O'Melveny & Myers,* 200 F.2d 420, 446, 454 (9th Cir. 1952), cert. denied sub nom. *Willhoit v. Fahey,* 345 U.S. 952 (1953); 12 U.S.C. §§ 692, 1426. Congress apparently intends that FNMA should be treated in the same fashion. Cong. & Ad. News, *supra.* Further evidence of this intent appears from the fact that FNMA's officers and employees are subject to federal civil service and classification laws. 12 U.S.C. § 1723a(d)(2), as amended (Supp.). Moreover, FNMA continues to possess the privileges conferred under 12 U.S.C. § 1723a and it remains subject to the general regulatory power of the Secretary of Housing and Urban Development. 12 U.S.C. § 1723(h).

The cases cited in support of the argument that FNMA is not a federal instrumentality did not deal with the question presented in the case at bar. *See Roberts v. Cameron-Brown Co.,* 556 F.2d 356, 358-60 (5th Cir. 1977); *Northrip v. Federal National Mortgage Association,* 527 F.2d 23, 30-32 (6th Cir. 1975). Rather they involved non-judicial foreclosures under a "power of sale" clause in a deed of trust. Unlike the foreclosure in the instant case, foreclosures under a "power of sale" clause involve rights created by contract and the Courts have held that "power of sale" foreclosures do not involve state action. *Charmicor v. Deaner,* 572 F.2d 694, 695 (9th Cir. 1978); *Bryant v. Jefferson Federal Savings & Loan Association,* 509 F.2d 511, 513-16 (D.C. Cir. 1974). Here, we are not concerned with whether FNMA is engaged in state or federal action when it institutes foreclosure under a "power of sale" clause in a deed. Since this was the only issue before the Courts in the *Roberts* and *Northrip* cases, *supra,* we do not believe that their decisions lend authoritative support to the position taken by appellants on this appeal.

We note with approval the decision of the district court in *Federal National Mortgage Association v. Lefkowitz,* 390 F.Supp. 1364, 1368 (S.D.N.Y 1975) which held that FNMA is a federal instrumentality and that the effect of a state statute upon FNMA's property may be considered to determine the validity of the statute under the supremacy clause of the United States Constitution. And we hold that an exercise of state power over a mortgage interest held by FNMA constitutes an exercise of state power over property of the United States.

III

The third and, in our opinion, the decisive issue in this lawsuit concerns the constitutionality of the City's foreclosure proceeding. What we are dealing with is in substance a supremacy clause question and we must decide whether the improvement lien could be enforced without first excluding the federal interest.

The rights conferred upon a purchaser by a treasurer's deed are set out in Section 6555 of the Streets and Highways Code which provides in pertinent part as follows:

> "The deed of the treasurer when duly acknowledged or proved, is primary evidence of the regularity of the proceedings theretofore had, and conveys to the grantee absolute title to the lands described therein, as of the date of the expiration of the period for redemption, free of all encumbrances, except: . . ."

On the dates of sale and conveyance to appellant Rust, FNMA held an assignment of a purchase money mortgage interest in the property. *The City made no attempt to protect this interest when it sold and conveyed the tract to Rust* and no allegation is made that FNMA's interest would be protected under any of the exceptions listed in Section 6555. By taking the position that it can convey absolute title in derogation of the federal interest, the City in effect asks this Court to extinguish FNMA's interest in the property. We believe that Congress did not intend for the City to have this power and that, in the absence of Congressional intent to the contrary, the action of the City cannot be sustained.

Our view of the situation is well expressed in the case of *City of New Brunswick v. United States, supra,* 276 U.S. at 555-56. There, land owned by an instrumentality of the United States was sold to purchasers who executed mortgages to the instrumentality to secure the balance of the purchase price. The city of New Brunswick assessed the property for taxes in the year following the sale and, when the taxes went unpaid, it instituted proceedings to sell the lots to satisfy its lien. On appeal from an order enjoining the sale, the Supreme Court held that the purchasers' interest could be subjected to sale but the interest of the instrumentality could not. In so holding, the Court recognized the paramount interest of the United States in the property and ordered the City to protect that interest by expressly excluding it from the tax sale.

The principle enunciated in the *New Brunswick* decision has found general application in other cases involving similar disputes over the state's authority to enforce its lien against a federal interest in property. *Roessling, supra,* 280 F.2d at 936; *S.R.A., Inc. v. Minnesota,* 327 U.S. 558 (1946); *Van Brocklin v. Tennessee,* 117 U.S. 151, 179 (1885). We agree with the reasoning expressed in those cases and with the statement in *United States v. General Douglas MacArthur Senior Village, Inc.,* 470 F.2d 675, 680 (2d Cir. 1972), *cert. denied sub nom. County of Nassau v. United States,* 412 U.S. 922 (1973) that "local governments cannot take any action to collect unpaid taxes assessed against property which would have the effect of reducing or destroying the value of a federally held purchase-money mortgage lien."

State legislation must yield under the supremacy clause of the Constitution to the interests of the federal government when the legislation as applied interferes with the federal purpose or operates to impede or condition the implementation of federal policies and programs. *Public Utility District of Pend Oreille v. United States,* 417 F.2d 200, 202 (9th Cir. 1969); *City of Los Angeles v. United States,* 355 F.Supp. 461, 465 (C.D. Cal. 1972). In this manner, the supremacy clause seeks to avoid the introduction of the disparity, confusion, and conflict which would follow if the Government's general authority is subject to local controls. *United States v. Allegheny County,* 322 U.S. 174, 183 (1944).

To sustain the action of the City in this case, we would run the risk of substantially impairing the Government's participation in the home mortgage market and of defeating the purpose of the National Housing Act. While we recognize that the City was engaging in a valid state function, this does not render its conduct constitutional or allow it to sell property without protecting the federal interest. *Perez v. Campbell,* 402 U.S. 637, 648-49 (1971); *S.R.A., Inc., supra,* 327 U.S. at 565-66. Accordingly, we hold that the foreclosure conducted by the City was invalid under the supremacy clause of the United States Constitution.

In an attempt to distinguish some of the decisions upon which we have based our holding, appellants contend those decisions involved federal interests created before the state and local liens attached and that the same protection does not apply where the federal interest arises subsequent to the attachment of the local lien. In support of this argument, appellants refer the Court to *United States v. Brosnan,* 363 U.S. 237 (1960) and *United States v. Cless,* 254 F.2d 590 (3rd Cir. 1958).

Appellants' contention confuses the validity and priority of the lien with the real issue in this lawsuit. We are not concerned with the authority of the City to make the assessment or with the priority under state law of the street improvement lien. The district court did not make any findings or conclusions on these issues. What we have decided is that under federal law the improvement lien cannot be enforced without protecting the federal interest.

The *Brosnan* and *Cless* decisions, *supra,* do not support or require a different conclusion from the one reached here. They involved a preliminary determination that state law should be the federal rule of decision. Under the state law applied in the *Brosnan* and *Cless* decisions, the interest held by the federal government could be subordinated and/or extinguished by non-judicial foreclosure proceedings. In a recent case involving the lending functions of the Small Business Administration (SBA) and the Farmers Home Administration (FHmA), the Supreme Court followed the same approach and held that "the prudent course is to adopt the readymade body of state law as the federal rule of decision until Congress strikes a different accommodation." *United States v. Kimbell Foods, Inc.,* 47 U.S.L.W. 4342, 4349 (April 2, 1979). We note, however, that Congress has indicated an intent to have state law govern interests held by the SBA and FHmA. *See* 15 U.S.C. § 646 and 7 U.S.C. § 1981(d), as amended (Supp.). Moreover, the SBA and FHmA operate under a set of rules and regulations which

allow them to individually tailor their loans. *See Kimbell, supra; United States v. Yazell,* 382 U.S. 341, 345-48 (1966); *United States v. California-Oregon Plywood, Inc.,* 527 F.2d 687 (9th Cir. 1975); *Ault v. Harris,* 317 F.Supp. 373 (D. Alas. 1968), affirmed 432 F.2d 441 (9th Cir. 1970).

FNMA, on the other hand, has little or no contact with its mortgagors and it does not individually negotiate the mortgage contracts it receives. As a secondary market facility, FNMA buys mortgages which are of such quality, type and class as those which meet the general purchase standards of private institutional investors. *See* 12 U.S.C. § 1719(a)(1), as amended (Supp.). Thus, it appears that FNMA operates on an entirely different plane and under a more elastic set of regulations than either the SBA or FHmA. To subject it to the same rules which govern the lending programs of the SBA and FHmA would either limit the types of mortgages which FNMA can purchase or require the corporation to participate in the negotiations between its assignor and the mortgagor. This would impair the liquidity in the home mortgage market which Congress hoped to achieve by creating FNMA and, by restricting the mortgages available to FNMA, it would be contrary to the express intent of Congress which has been to expand rather than to limit the corporation's market. 12 U.S.C. § 1716(a); Code Service, *supra,* at 2042; Cong. & Ad. News, *supra,* at 2944.

This is not a case where Congress has allowed the federal interest to be subject to state law. *Compare* 15 U.S.C. § 646 and 7 U.S.C. § 1981(d), as amended (Supp.). Nor is it a case where the federal instrumentality can easily protect itself by including a clause in the mortgage contract stating that it is exempt from state law because FNMA is not a party to the original contract. Consequently, we believe that state law should not be applied as the federal rule of decision in cases involving the lending functions of FNMA and that existing

federal law should control. *See generally United States v. View Crest Garden Apartments, Inc.*, 268 F.2d 380, 383 (9th Cir. 1959), cert. denied 361 U.S. 884 (1959); *Clark Investment, supra,* 364 F.2d at 9; *United States v. Stadium Apartments, Inc.*, 425 F.2d, 364-65 (9th Cir. 1970); *Branden, supra,* 293 F.Supp. at 873; *United States v. Forest Glen Senior Residence,* 278 F.Supp. 343, 344 (D.Ore. 1967); *cf. United States v. MacKenzie,* 510 F.2d 40 (9th Cir. 1975). Under federal law, as it is set forth in this opinion, the action of the City to collect payment on the bond without protecting the federal interest was an unconstitutional exercise of state power over property of the United States. Therefore, the sale to appellant Rust cannot be upheld.

IV

A number of other issues are argued by the parties. Because we reach the conclusion that the sale was invalid, consideration of these other issues is unnecessary to our decision in this case and we express no opinion on the treatment they received in the court below. *Immigration & Naturalization Service v. Bagamasbad,* 429 U.S. 24, 25 (1976).

The judgment of the district court is AFFIRMED.